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Investors have been trading on war news and ignoring the economic data, believes one leading economist. (David Karp/AP Photo)

Economy on the Edge

'Rude Awakening' May Be in Store, Following Iraq War

By Ramona Schindelheim



April 8 — The U.S. stock market seems to gain on every bit of good news out of Iraq. But don't confuse the stock market with the economy.

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A number of economists are warning — based on recent weaker-than-expected economic data — that the economy is faltering. A few go as far as to say that we are close to another recession.

"Investors could be in for a rude awakening" once the war comes to an end, according to David Rosenberg, chief North American economist for Merrill Lynch in New York. In a report to clients of Merrill Lynch Monday, he warned, "the economy is back on the precipice of recession."

Investors have been trading on war

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news and ignoring the economic data, believes Rosenberg. "The markets do not seem to be priced for the weakness that we expect in the economy."

The economist also argued another month of significant job losses would likely push the economy over the edge.

Last Friday, the Department of Labor reported the economy lost 108,000 in March and 357,000 in February, for a total of 465,000 in two months. And there is evidence job losses are continuing to pile up this month. Recent data from the states show the number of people walking into unemployment offices around the country to file first-time claims for benefits rose to 445,000 in the final week of March. They'll show up in the April jobless report.

Rosenberg also expressed concern about the slowing in consumer and business spending and the moderating housing demand.

Underlying Weakness

Many economists acknowledge the war has contributed to the slowdown in spending, both on the consumer and the corporate levels. But few believe an end to war will be the remedy for this ailing economy.

Economists for JP Morgan in New York were among those warning that the economy is at a dangerous crossroads. "The "U.S. is close to recession," according to JP Morgan's

Bruce Kasman and David Hensley.

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"There is genuine comfort to be taken as the main drags producing this downshift — war fears and rising energy prices — appear to be lifting," they wrote last Friday.

"However," they continued, "it would be wrong to conclude that the [global] economy is poised for a quick turnaround. U.S. data strikes an important cautionary note: labor market and other business indicators are sending a weaker signal that they did at anytime in the aftermath of other temporary shocks ..." That thought was echoed by Joshua Shapiro, chief U.S. economist for MFR Investments in New York. "While there is no doubt that the war has acted to restrain activity, it remains our view that the economy still has many underlying problems.

Also agreeing was William Dudley, chief economist for Goldman Sachs in New York, who wrote, "With the notable exception of auto sales, other indicators for March were weak. ISM (manufacturing and service) indexes registered broad-based weakness, and stubbornly high claims for unemployment insurance imply that labor-market deterioration has continued."

Dudley said the continued loss of jobs could "quickly transform economic weakness into a self-reinforcing process."

Pent Up Demand?

A handful of economists suggest that the slowdown in consumer and business spending could lead to a bit of pent up demand.

Steven Wieting, Salomon Smith Barney senior U.S. economist, wrote Monday that "Data do suggest that there have been some meaningful negative effects in business purchases, business costs and consumer activity." He added this provides a "modest" pent up demand, which could spur some growth after the fighting subsides.

The Blue Chip Economic Survey also shows an increasingly somber assessment of the current economy by the nation's top economists, but holds out hope for some acceleration in growth in the second half of the year.

The economists lowered their forecast for economic

growth for the first three months of the year to 1.8 percent from the previous 2.2 percent. The editor of the survey, Randell Moore, described the recent data as "disquieting".

But the economists also believe that "the war will come to a relatively quick conclusion and that the U.S. establishment of a new government in Iraq will go smoothly." They believe that will help relieve some consumer and business nervousness, which will lead, hopefully, to a pick-up in spending.

For Jobless, War Isn't Problem ... or Solution

Over the last two years the economy has lost 2 million jobs. And with hundreds of thousands of workers filing new unemployment claims every week, it's likely to lose some more.

The war in Iraq is one more black cloud over the job market, one more reason for nervous employers *not* to hire — for some, a reason to cut the workers they do have.

Sandy Perryman, 37, is one of 10,000 airline workers who have been laid off since the war began. "With the war people are like, 'Oh, I don't want to fly anymore, I don't want to go anywhere, I just want to stay home where I am safe and secure,'" says Perryman.

But for many of the 8.4 million Americans unemployed and looking for work last month, war was not the problem. And the end of it may not be the answer.

"It's not going to solve everybody's problems by a very long shot," advises Bill Cheney, economist with John Hancock Financial Services.

It's unlikely to do much for Lori and Lisa Porcher. The 30-something sisters have been out of work for almost nine months. Lisa is one of hundreds of thousands of technology workers waiting for the dot-com bubble to stop bursting.

"It's to the point where you have to reconsider your professional expertise," Lisa laments.

And Lori is an advertising executive who wonders when

that industry will revive. "I'm about to exhaust my extended unemployment benefits, so at this point, where do I go?"

Lots of workers are willing to switch fields to find jobs. But that's hard now, too. Last month there were job losses across the board, from government workers to retail and restaurants, and, once again, manufacturing.

— *Betsy Stark*

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